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July 22, 1999

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VIA AIRBORNE EXPRESS

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 Twelfth Street, SW; TW-A325
Washington, DC 20554

Re: CC Docket No. 96-45
CC Docket No. 97-160
CC Docket No,. 96-262

Dear Ms. Salas

The Consumer Advocate Division of the Public Service Commission of West Virginia hereby submits the enclosed original and four (4) copies of the Comments of the West Virginia Consumer Advocate on the Methodology Order Further Notice of Proposed Rulemaking.

A diskette containing the Comments has been submitted to Sheryl Todd, Accounting Policy Division and also to the International Transcription Service, Inc. in accordance with the FCC's instructions.

If you have any questions, please do not hesitate to contact the undersigned.

Respectfully,

Gene W. Lafitte, Jr.
Counsel for Consumer Advocate

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Enclosures

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Forward-Looking Mechanisms for High-Cost Support for Non-Rural ILECs	)	CC Docket No. 97-160
	)	
Access Charge Reform	)	CC Docket No. 96-262

COMMENTS OF THE WEST VIRGINIA CONSUMER ADVOCATE ON THE METHODOLOGY ORDER FURTHER NOTICE OF PROPOSED RULEMAKING

On May 28, 1999, the Federal Communications Commission ("Commission") issued its Seventh Report and Order in the Universal Service proceeding, its Fourth Report and Order in the Access Charge Reform proceeding, and a Further Notice of Proposed Rulemaking ("FNPRM"), collectively referred to herein as "the Methodology Order."[1] In the Methodology Order the Commission sought comment on major revisions proposed to the system of federal universal service support first set out in its May 7, 1997, First Report and Order on Universal Service.[2] On June 29, 1999, the Commission extended the time for the filing of comments in response to the Methodology Order. The Consumer Advocate Division of the Public Service Commission of West Virginia ("West Virginia Consumer Advocate") hereby submits these comments in accordance with the June 29, 1999 Order. As set forth below, the West Virginia Consumer Advocate believes that at the

[1] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, *Access Charge Reform,* CC Docket No. 96-262, Seventh Report and Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45, Fourth Report and Order in CC Docket No. 96-262, and Further Notice of Proposed Rulemaking, FCC 99-119 (May 28, 1999).

[2] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, First Report and Order (May 7, 1997).

present stage of the development of local competition, the multiple goals of the Telecommunications Act of 1996 can best be met by continuing to determine federal universal service support on the basis of study areas which encompass a company's entire service territory within a state.

1. The Proposed Commission Methodology

In the Methodology Order, the Commission set forth a framework for determining federal universal service support for high-cost areas served by non-rural ILECs. Simultaneously, the Commission issued its Inputs Order[3], and invited parties to test its proposed framework by running the forward-looking cost model using different assumptions. Under the proposed framework, federal universal service support would be determined by two basic steps. First, the Commission's forward-looking cost model would be run for all wire centers of all non-rural telephone companies in the nation. Second, if a company showed costs above a national cost benchmark, then the Commission would determine if a state's internal resources were sufficient to support these high costs without additional federal support. The Commission proposed that state support be established as a specific per-line dollar amount.[4] If the costs of a non-rural company within a state exceeded the benchmark plus the state per-line amount, then additional federal support would be indicated. The Commission asked for comments on virtually every element of this proposed framework.

The West Virginia Consumer Advocate supports the framework proposed by the Commission. If properly implemented, the proposed system has the potential of providing sufficient federal universal service support to maintain rate comparability, while at the same time not

[3]*Federal-State Joint Board on Universal Service*, CC Docket 96-45, *Forward-Looking Mechanism for High-Cost Support for Non-Rural LECs*, CC Docket No. 97-160, Further Notice of Proposed Rulemaking, FCC 99-120 (May 28, 1999).

[4]Methodology Order, ¶¶63; 110, 111.

imposing a burden on customers through unwarranted expansion of the federal fund. Moreover, the proposed framework has the flexibility to adapt in response to actual experience as local competition actually develops. As discussed below, the West Virginia Consumer Advocate supports use of a company's entire study area within a state in order to determine costs; a national cost benchmark of 135% of national average costs; and state per-line responsibility of $2 per month. If additional federal support is indicated in order to maintain rate comparability, this support should not be used to reduce federal interstate access charges. The particular use of additional federal funds necessary to maintain comparability should be left to the states. The West Virginia Consumer Advocate would stress that each of these recommendations is dependent on, and made in conjunction with, the other recommendations made herein.

2. The Study Area Should Be Used for Determining Federal Universal Service Support

Currently, federal universal support for non-rural companies from the high-cost fund is based on a company's overall costs[5] within a "study area," that is, the entire service territory of a company within any one state. Use of the study area takes into account both high-cost and low-cost exchanges served. Federal support is given to the extent that the overall costs of a company within a study area exceed 115% of the national average. In the Second Recommended Decision, the Federal-State Joint Board recommended that study areas continue to be used for purposes of determining the need for federal universal support for non-rural companies. In the Methodology Order, the Commission asked for comment on the Joint Board's recommendation, as well as several alternatives which would determine support on a more granular level. Specifically, the Commission sought comment

[5]Under the current high-cost fund, support is given to non-rural companies only for high loop costs. Under the proposed forward-looking cost model, all of a company's costs would be considered.

on proposals to determine support based on costs at the wire center level, at the UNE cost zone level, and at the study area level.[6]

The West Virginia Consumer Advocate supports continued use of study areas for determination of federal universal service support. While the costs of each wire center should be established by the forward-looking cost model, the totality of costs incurred by a company in serving customers within a state - customers in both high-cost and low-cost exchanges - should be used by the Commission in evaluating whether there is a need for a transfer of funds from other jurisdictions in order to maintain comparable rates.

If and when local competition begins to erode implicit, intrastate support for affordable rates in high-cost areas, such erosion will be reflected in rising overall costs within a company's study area.[7] In this way, any growth in the federal fund will match the actual growth in local competition. Moreover, use of the study area will allow federal support to be based on a company's actual overall performance in relation to that competition. In other words, additional federal universal service support should be given when a company's and state's internal resources together are insufficient to maintain comparable rates within that company. Focusing only on the number of high-cost lines served, or only on the number of low-cost lines lost, does not tell the whole story. Even if a company serves high-cost lines, there should not be a need for federal support if the company also serves a large number of low-cost lines. Even if a company suffers competitive losses among its low-cost lines, there should not be a need for federal support if the company is also experiencing

[6]Methodology Order, ¶¶103-106.

[7]For example, as an incumbent loses customers in low-cost exchanges, the average costs within the study area will rise since there will be relatively fewer low-cost customers and relatively more high-cost customers. This example assumes that the number of low-cost and high-cost lines remains static. As discussed above, this assumption does not comport with the reality of access line growth.

robust access line growth in low-cost areas which offsets these competitive losses. In this regard the Commission should note recent reports of financial analysis firms which point out that revenue and access line growth for ILECs have outstripped competitive losses.[8]

The study area proposal should apply to all ETCs, not just incumbent LECs. In other words, in determining whether any ETC should receive federal universal service support, the evaluation should be based on the costs of all lines served by an ETC within a study area. Since costs will be determined by the cost model at the wire center level, support will be transparent - every competitor will know how much support is available for every wire center - and portable - every ETC will be eligible to receive the same per line support for serving customers within an exchange as does an incumbent.

Although forward-looking costs should be determined at the wire center level, federal universal service support should not be based on the costs of each wire center in isolation. As set forth above, the costs of all wire centers served within a study area should be combined for purposes of determining federal support. Use of the costs of each wire center in isolation focuses on only high-cost exchanges. Not only does this greatly increase the size the fund, it does not recognize the low-cost lines served by a carrier within the same study area. While it may be that over time the advance of local competition will erode this implicit subsidy from low-cost to high-cost exchanges within each state, the fact remains that this implicit support does exist today and has not been significantly eroded by local competition which has actually developed. In fact, incumbent LECs continue to post healthy earnings in spite of the advance of local competition. Any system of

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[8]See for example, *Telecom Service-Local*, Merrill Lynch, Dec. 3, 1998: "We believe the RBOC/ GTE group's growth drivers, which were more than sufficient to offset accelerating share loss to competitors and the deceleration of cellular, are sustainable through 1999 and beyond." See also, *Telecom Services-Local*, Merrill Lynch, Oct. 5, 1998.

universal support adopted by this Commission must recognize these realities.

As stated above, if federal universal support focuses only on high-cost exchanges and ignores the implicit subsidies from low-cost exchanges, a great increase in federal universal service funding will be indicated. Not only will this place a greater burden on all phone customers across the nation, it will present problems in how incumbents should use the increased funds. Substantial additional federal funds will result in either: (1) a windfall for incumbents from the increased funding if no offsetting rate reductions are made; or (2) the need for regulators, rather than the market, to make a determination of where rates should be lowered. Ironically, if additional federal funds are used to reduce rates in low-cost areas to be closer to cost[9], this will have the effect of stifling, rather than incenting, local competition. In essence, the lowering of rates in low-cost areas through the receipt of federal universal service funds will amount to a strategic pre-emptive strike by incumbents against the growth of local competition by making it more difficult for new entrants to underprice the incumbent, and thus gain a foothold in the market.

At paragraph 103 of the Methodology Order, the Commission expressed concern that use of a study area to determine a need for federal funds wouldn't provide incentives to provide competition in rural areas. As discussed above and below, use of a study area does not preclude determination of costs at the wire center level. Nevertheless, it should be pointed out that at this stage of development, the Commission should be concerned with getting local competition started <u>anywhere</u>. There is no doubt that new entrants will seek to first provide service in urban and low-cost areas where customer densities justify the substantial investment necessary to provide adequate service. Although everyone hopes that local competition will eventually spread to rural and high-

[9]Use of federal funds to lower rates in low-cost areas would also turn on its head the requirement in Section 254(e) of the Act that universal service funds be used "only for the provision, maintenance, and upgrading of facilities and services for which the support is intended."

cost areas, there is no doubt that local competition will have to start in the low-cost urban areas. Unfortunately, to date there has been precious little actual local competition in any area, high-cost or low-cost. For example, in the state of West Virginia virtually no access lines are being served by any competitor on any basis. Given the current paltry amounts of local competition, the Commission should do everything in its power to incent the development of local competition. Establishing a federal universal service system based only on costs at the wire center level, in hopes that this will incent competition in rural areas, will only end up crushing competition where it should first naturally develop, in low-cost and urban areas.

At paragraph 106 of the Methodology Order the Commission states: "If high-cost support is provided using study area averaged costs, then all lines within the study area would be eligible for the same amount of support... ." This is not necessarily so. Under the framework recommended herein, costs would be determined by the forward-looking cost model for each wire center, but would be combined with all lines served within a service area to evaluate a need for federal support. For an incumbent this would result in an average amount of support per line derived by dividing total support by total number of access lines within a study area. However, the support would actually be the result of combining the costs of all lines served by that incumbent, high-cost and low-cost.

On the other hand, if we assume that a competing ETC served only one customer in a study area, and that the customer was located in a high-cost exchange, the costs of which exceeded the national benchmark and state per-line support by $10 per line per month, the competing ETC would receive federal support of $10 per month[10], and the incumbent LEC would lose support for one access line. The incumbent's average costs per line would also change. If the competing ETC

[10]This example assumes that the competing ETC has met all the conditions for receiving the full amount of per line support for that exchange. In other words, the customer in the high-cost exchange is not served by resale or UNEs.

served another customer in another exchange, the costs of which exceeded the benchmark and state support by $2 per line per month, the competing ETC would receive $2 per month. Although the competing ETC would receive an average of $6 per month in federal support for serving both these customers, this average would be made up of serving different customers in different exchanges with different costs. The average per line support received by the competing ETC could be the same as, but most likely would be different from, the average per line support received by the incumbent. The average support for each company would be a function of the customers and areas served by each company within a study area.

Also at paragraph 106 of the Methodology Order the Commission asks for comment on arbitrage opportunities if study areas are used for universal service purposes, but UNE prices are based on three rate zones within each state. The Commission's arbitrage example was based on the assumption that all per-line support within a study area would be the same. As explained above, this assumption is not necessarily correct. Forward-looking costs should be determined on a wire center level, but support should be based on overall study area costs. Nevertheless, there would still be the opportunity for arbitrage to the extent that wire center support varied from density zone UNE prices. However, if such limited opportunities provide an incentive to bring competition to high-cost areas, so much the better.

Finally, in paragraphs 107 - 109 of the Methodology Order, the Commission asked for comment on four proposals designed to keep the size of the federal fund at manageable levels. Because the West Virginia Consumer Advocate believes that the framework discussed above, which determines costs at the wire center level and combines them at the study area level, will result in a reasonably sized federal fund which will respond as competition actually develops, each of the proposed alternates is unnecessary. The framework for federal funding should be reviewed periodically. If it appears at a later date that the actual development of local competition requires a change in the area over which the need for federal funding is evaluated, or in other elements of the framework, then changes can be made at that time in light of actual experience.

3. The Commission Should Adopt a National Cost Benchmark of 135% of Average Costs

In the Second Recommended Decision, the Joint Board recommended that a cost benchmark, rather than a revenue benchmark, be used to determine the need for federal support, and that the cost benchmark be established between 115% and 150% of national average costs. In paragraph 99 of the Methodology Order the Commission asked for comments on a specific benchmark level, and noted that a benchmark near the center of the range would produce results sufficient to preserve and advance universal service goals. The West Virginia Consumer Advocate agrees and recommends that a cost benchmark of 135% of the national average be used in determining a need for federal support. A cost benchmark of 135%, used in conjunction with the study area discussed above, and the $2 per line state responsibility discussed below, should produce a federal high-cost fund for non-rural companies of approximately $500 million. This would represent only a slight increase over current high-cost funding for non-rurals of approximately $300 million. As discussed above, if and when local competition actually erodes the ability of companies and states to support service to high-cost areas, use of study areas will provide for increases in funding sufficient to maintain universal service.

4. State Per-Line Responsibility Should Be Set at $2

In the Second Recommended Decision, the Federal-State Joint Board recommended that even if the cost benchmark indicated a need for additional federal support, a state's ability to support high-cost areas should first be considered. The Joint Board recommended, *inter alia*, that this state support should be established between 3% and 6% of intrastate revenues, or as a set per-line amount of state support per access line. In paragraph 111 of the Methodology Order the Commission requested comment on its proposal to establish a fixed per line amount for purposes of considering a state's ability to support high-cost areas. In its proposal the Commission noted that a $2 per line figure would roughly equal 6% of its previously proposed $31 per line revenue benchmark.

The West Virginia Consumer Advocate supports use of a fixed per line amount, which should be initially established at $2 per line. Although all states vary in demographics and per capita income, the ability of states to make a modest assumed $2 contribution to support high-cost areas within their borders should not vary. Moreover, use of a fixed $2 per line figure will make the framework for federal support administratively easy to apply, and remove controversy from determination of support on a state-by-state basis. If experience shows that the $2 per line state contribution is too little or too great, then the Commission can adjust the assumed contribution level at a later date.

5. The Interrelationship of Universal Service and Access Charge Reform

In paragraph 43 of the Methodology Order, the Commission stated that universal service and interstate access reform are interrelated. That is, elimination of any implicit subsidies from interstate access may create a corresponding need for additional federal universal service support of certain ILECs. Nevertheless, the Commission made clear that it is following two distinct tracks: (1) ensuring rate comparability between rural and urban areas and among states; and (2) eliminating implicit subsidies from interstate access.

Under the first track, the Commission proposes to use a forward-looking cost model to identify high-cost areas. If state resources as measured by specific per-line contributions are not sufficient to offset these high costs, then additional federal universal service support may be necessary to maintain rate comparability. Under the second track, the Commission proposes to perform a separate analysis of the costs underlying interstate access rates. If it is determined that interstate access is above cost, and contains implicit subsidies for intrastate service, then such support will be made explicit. This could result in reductions in interstate access rates and increases in federal universal service support to offset these reductions.

The West Virginia Consumer Advocate urges the Commission to keep these inquiries separate, and to resist any suggestion that a showing of a need for additional support under track one, should result in a reduction in interstate access under track two. As set forth above, the analysis under each track is entirely independent. If analysis under track one shows that costs in a state are particularly high, and that state resources are not sufficient to offset those high costs, additional federal support is needed to ensure rate comparability. This means support for intrastate rates in that state. Reductions in federal interstate access charges based on extremely high costs within a state will do nothing to ensure rate comparability for that state. In fact, reductions in interstate access will do just the opposite by placing even greater pressure on local rates to rise.

Commission actions on interstate access charge reform must be based on a separate and independent analysis of those access charges. While the results of that analysis may indicate a need to reduce interstate access and increase federal universal service support, this should not affect the level of federal support necessary to maintain rate comparability for local intrastate costs.

6. Determination of Use of Any Additional Federal Funding

As a final matter, it must acknowledged that implementation of a new federal universal framework may result in increases in federal funds for some non-rural companies in some states.[11] If there are increases in federal funds, the determination of the use of these funds should be left to each state. As the Commission has noted, each state commission will be familiar with the rate structure in each state, and the needs of high-cost areas in that state. Accordingly, states should be in the best position to determine how these additional funds should be used to preserve and enhance affordability and rate comparability within that state.

Respectfully submitted,

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[11] The "hold harmless" proposal will apparently prevent any decreases in funding to any state.